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SUBJECT: Brazil: Tax Agency Chief Under Investigation

11. Summary: On November 18, 2005, federal prosecutors filed a civil lawsuit against Jorge Rachid, Secretary of the Ministry of Finance's Secretariat da Receita (i.e., the Brazilian counterpart of the U.S. Internal Revenue Service) alleging "administrative improbity." Prosecutors are seeking to have Rachid, along with one of his assistants, Ricardo Pinheiro, removed from office. In addition, they are pushing to have the pair's assets frozen so these goods can be used to compensate the GOB for the losses (the precise amount has not yet been calculated) it may have suffered due to Rachid's actions. Separately, the GoB suffered a setback when a scandal-distracted Congress failed to ratify a Provisional Measure (presidential decree) combining Receita Federal with the revenue gathering arm of Brazil's social security system, Receita Previdenciaria. The GoB likely will seek to resurrect the failed merger, which aims to make its tax collection arms more efficient. End Summary.

The Case Against Rachid

12. The allegations against Rachid date from 1994 when he was a fiscal auditor in Salvador, Bahia. Prosecutors affirmed that Rachid acted with negligence in favor of two friends representing one of the largest construction companies in Brazil -- OAS. Specifically, Rachid was part of a group of Receita Federal auditors responsible for issuing a fine of R\$1.1 billion (well over US\$1 billion at the exchange rates prevailing at the time) against OAS. Later during the proceedings, the amount of the fine was dropped to R\$25 million. Prosecutors are accusing Rachid of negligence through the use of the wrong formula to calculate the amount owed by OAS. They believe that Rashid associates Sandro Martins and Paulo Baltazar, both OAS representatives, pocketed R\$18.3 million (US\$ 8.3 million) in the wake of the large reduction in the assessed fine.

13. Prosecutors also believe that since 2003 Rachid has been taking advantage of his position to impede the investigation into himself and his OAS associates. For instance, in 2003, Martins served as Rachid's special assistant for 3 months. In addition, on October 6 of this year, Rachid signed a decree making it possible for him, under certain circumstances, to remove a member of the commission which was looking into the charges against him. Meanwhile, Ricardo Pinheiro, Rachid's assistant, is being sued along with Rachid as Pinheiro managed the 1994 audit against OAS.

The Death of the Super Receita

14. After the no show of at least 41 senators at the Senate's voting session on November 18, Medida Provisoria 258 (MP258) which would have created a "Super Receita" -- i.e., the integration of Receita Federal with the Receita Previdenciaria (the US counterpart of Social Security) expired. Many observers felt that having Receita Federal work in conjunction with Receita Previdenciaria was an eminently sound idea. A Super Receita would facilitate and increase tax collection and simplify and stimulate better and more efficient procedures, thus helping to reduce tax evasion. However, in order for all this to happen, both the Chamber of Deputies and the Senate would have had to approve MP 258 within 120 days of its issuance. They never did, principally because of the continued distractions from the ongoing political corruption scandal.

15. Still, the GOB hasn't given up on the idea. It is already working on developing a formal law (Projeto de Lei) reestablishing the Super Receita. However, for foreseeable future the Super Receita will not be an easy sell for GOB. Opposition parties such as the PFL, PSDB and PDT aren't buying the proposal, noting that the GOB is trying to concentrate too much power in one place. Not even industry and the entrepreneurial sector has been able to budge the opposition on this. And as an election year is just around the corner, chances are considerably diminishing for both

sides - the GOB and the opposition -- to reach an agreement on the Super Receita.

Next Steps for Rachid and the Super Receita

16. Coincidence or not, the timing of events has been good for Rachid. Under enemy fire, he has been nominated, by President Lula, to command simultaneously both Receita Federal and Receita Previdenciaria while the GOB tries to gain approval of the formal law uniting them. This is the first time that one person has been tapped to lead at the same time two secretariats within two separate ministries: Finance and Social Security. The elevation of Rachid to "Super Secretary" of the still separate Receitas is not only a device for the GOB to keep the dream of the Super Receita alive, but it is a sign that the Lula administration plans to stick with Rachid notwithstanding the current allegations against him.

17. Still, Rachid continues to face challenges as ongoing strikes at Receita Federal continue to impede that agency's work. On November 22, Receita's fiscal auditors and technicians returned to work after extended stoppages. Employees have threatened to return to the picket line if the GOB sends to congress the formal law proposing the creation of the Super Receita.

Chicola